

## Message Text

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ACTION EUR-25

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LAB-06 SIL-01 OMB-01 DODE-00 PM-09 H-02 L-03 NSC-10

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TAGS: ECON, OECD, US

SUBJECT: EDRC ANNUAL REVIEW US ECONOMY, MAY 2

REF: EDR(73)8

DEPT. PASS CEA, TREAS, FRB, LAB, COMM.

1. SUMMARY: DRAFT SURVEY NOTES AS RECOVERY ACTIVITY BEING COMPLETED, US ECONOMY MOVING INTO CRITICAL PHASE FOR STABILIZATION POLICY. ESSENTIAL THAT AGGREGATE DEMAND SLOW DOWN TO POTENTIAL RATE GROWTH. BALANCE PAYMENTS DEVELOPMENTS DISAPPOINTING BUT PROGRESSIVE MAJOR IMPROVEMENT NOW SEEMS LIKELY AS ECONOMIC ACTIVITY EXPANDS ABROAD AND AS RESULT DEVALUATION US DOLLAR. END SUMMARY.

2. WASHINGTON AGENCIES HAVE HAD OPPORTUNITY TO SEE AND COMMENT ON EARLY DRAFT OF REF DOC. THIS CABLE THEREFORE WILL ONLY HIGHLIGHT POLICY CONCLUSIONS SECTION OF REVISED DRAFT SURVEY, EDR(73)8, WHICH WILL BE USED AS LIMITED OFFICIAL USE

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BASIS DISCUSSION IN REVIEW US ECONOMY ON MAY 2. COPIES OF REFDOC WERE AIR POUCHED WASHINGTON APRIL 19; INDIVIDUAL COPY HAS BEEN SENT STEIN, CEA. SECRETARIAT FOUND WASHINGTON COMMENTS " EXTREMELY HELPFUL" AND HAS INCLUDED MOST IN REFDOC.

3. HIGHLIGHTS OF POLICY CONCLUSIONS: RECOVERY ECONOMIC ACTIVITY OVER PAST YEAR HAS CONTINUED AT HIGH RATE AND UNEMPLOYMENT HAS BEEN REDUCED. PRICE PERFORMANCE HAS BEEN UNEVEN WITH IMPROVEMENT 1972 FOLLOWED BY LESS SATISFACTORY PERFORMANCE RECENT MONTHS. BALANCE PAYMENTS DEVELOPMENT HAS BEEN DISAPPOINTING BUT PROGRESSIVE AND MAJOR IMPROVEMENT WOULD NOW SEEM BE LIKELY, BECAUSE OF STRONGER EXPANSION ACTIVITY ABROAD AND PARITY CHANGES MADE PAST 18 MONTHS.

4. OVER NEXT 12 TO 18 MONTHS, ECONOMIC POLICY WILL BE PUT TO CRUCIAL TEST, AND TO AVOID EXCESS DEMAND IT IS ESSENTIAL THAT AGGREGATE DEMAND BE SLOWED DOWN TO POTENTIAL GROWTH RATE. BOTH US AUTHORITIES AND SECRETARIAT EXPECT EXPANSION SLOW DOWN SECOND HALF 1973 AND INTO 1974 TO RATE CLOSER TO GROWTH OF POTENTIAL. PROSPECTS AVOID EXCESS DEMAND THUS GOOD, BUT CLEAR THAT ECONOMY NOW MOVING INTO CRITICAL PHASE FOR STABILIZATION POLICY. UNCERTAINTIES INCLUDE FEDERAL BUDGET FOR 1974, WITH PROSPECTS EXPENDITURES GOING BEYOND ADMINISTRATION'S PROPOSALS, AND AT THIS PHASE CYCLE POSSIBLE UNDERESTIMATION FUTURE STRENGTH DEMAND.

5. NOT CLEAR HOW MUCH DEMAND MANAGEMENT POLICY IN US CAN BE CHANGED TO ADJUST TO CHANGES IN DEMAND OUTLOOK. CONSIDERABLE FLEXIBILITY IS POSSIBLE IN MONETARY POLICY, AND FURTHER TIGHTENING MAY WELL BE REQUIRED BRING PACE EXPANSION DOWN TO NORMAL. TIGHTENING WOULD ALSO BE DESIRABLE TO STRENGTHEN BALANCE PAYMENTS CAPITAL ACCOUNT BEFORE FULL EFFECTS DEVALUATION FELT. HOWEVER, IT PROBABLY UNDESIRABLE LET MONETARY POLICY CARRY WHOLE BURDEN POLICY ADJUSTMENT AS IN 1959, 1966/67 AND 1968/69, ENTAILING DISTORTED DEMAND AND RISK DOWNTURN ACTIVITY.

6. RE FISCAL POLICY, LESS CLEAR HOW QUICKLY TIGHTENING COULD BE EFFECTED. SHIFT IN COMPOSITION OF BUDGET RECENT LIMITED OFFICIAL USE

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YEARS FROM SPENDING ON GOODS AND SERVICES TOWARD TRANS-

FERS AND GRANTS MAKES FURTHER EXPENDITURE CUTS DIFFICULT AND PROBABLY UNDESIRABLE ON SOCIAL CONSIDERATIONS. SOME FORM TAX ACTION MAY THEREFORE BECOME NECESSARY, PARTICULARLY IF FEDERAL EXPENDITURES RISE FASTER THAN SUGGESTED IN FY 1974 BUDGET. HOWEVER, TAX CHANGES UNDER PRESENT LEGISLATIVE ARRANGEMENTS TAKE CONSIDERABLE TIME, AND IT WOULD SEEM MORE FLEXIBLE FISCAL ARRANGEMENTS NEEDED. IT IS THEREFORE HOPED FURTHER CONSIDERATION WILL BE GIVEN TO GRANTING PRESIDENT LIMITED STANDBY AUTHORITY TO VARY TAX RATES AND CERTAIN TYPES EXPENDITURES WITHOUT PRIOR LEGISLATIVE CONSENT.

6. RECONCILIATION HIGH EMPLOYMENT WITH SATISFACTORY PRICE PERFORMANCE HAS BEEN COMPLICATED BY CHANGES IN LABOR MARKET LAST 15 YEARS. IN THIS SITUATION, GENERAL DEMAND MANAGEMENT, EVEN IF PERFECTED AS TO DEGREE RESPONSE AND TIMING, LIKELY PROVE INADEQUATE AND THEREFORE NECESSARY SEEK " ANCILLARY APPROACHES" ACHIEVE ECONOMIC GOALS SIMULTANEOUSLY. POLICIES ON SUPPLY SIDE CAN BE HELPFUL IF GIVEN TIME, E. G., PUBLIC SECTOR EMPLOYMENT PROGRAMS TO PROVIDE PRODUCTIVE JOBS AND TRAINING. MAN-POWER PROGRAMS SHOULD NOT BE TOO NARROWLY FOCUSED ON PROBLEMS OF DISADVANTAGED AND SHOULD NOT BECOME MAINLY SOCIAL POLICY FOR REDISTRIBUTING INCOME. SUCH PROGRAMS SHOULD BE EXPANDED AND DESIGNED TRAIN FOR AND FILL JOB VACANCIES AT ALL SKILL LEVELS, THUS REDUCING UNEMPLOYMENT IN CERTAIN AREAS AND LIKELIHOOD SERIOUS LABOR MARKET BOTTLENECKS IN PERIODS STRONG ACTIVITY.

7. POSSIBILITIES EXIST FOR EXERCISING GREATER SELECTIVITY DEMAND MANAGEMENT; E. G., REGULATE INVESTMENT ACTIVITY BY VARIABLE DEPRECIATION ALLOWANCES. RESTRICTIVE BUSINESS PRACTICES BOTH LABOR AND BUSINESS COULD BE REDUCED. GOVERNMENT POLICIES AND REGULATIONS - QUOTAS, PRICE MAINTENANCE LAWS, AGRICULTURAL POLICIES, MINIMUM WAGE LAWS - MIGHT BE REASSESSED WITH VIEW TO MAKE WAGES AND PRICES MORE RESPONSIVE TO BALANCE BETWEEN SUPPLY AND DEMAND IN PRODUCT AND FACTOR MARKETS.

8. RE PERMANENT SYSTEM PRICE SURVEILLANCE, IT MAY BE DESIRABLE FOR AUTHORITIES TO HAVE CONTINUING MEANS INTER-LIMITED OFFICIAL USE

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VENTION IN IMPERFECTLY COMPETITIVE MARKETS. ALTHOUGH SOME RELAXATION PHASE II STANDARDS APPEARED APPROPRIATE, IT REMAINS BE SEEN WHETHER EXTENSIVE DISMANTLING PHASE II CONTROLS DOES NOT TURN OUT BE PREMATURE. HOWEVER IT IS RECOGNIZED ADMINISTRATION HAS RETAINED AND WILL

USE CONSIDERABLE POWER INTERVENE MARKETS PREVENT EX-  
CESSIVE WAGE AND PRICE RISES.  
BROWN

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